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INFO AMEMBASSY CANBERRA

AMCONSUL MELBOURNE

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SUBJECT: ANNUAL REIVEW OF AUSTRALIA

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1. SUMMARY: EDRC REVIEW OF AUSTRALIA ON FEBRUARY 21
SOMEWHAT INCONCLUSIVE REGARDING SHORT TERM OUTLOOK
AND POLICIES. AUSTRALIANS SEEMED RELATIVELY UNDIS-
TURBED REGARDING INFLATION, WHICH EDRC CONSIDERED
MAIN DANGER IN VIEW OF RAPIDLY RISING WAGES, PLANNED
INDEXATION, AND EXPECTED INCREASES IN PUBLIC EXPENDI-
TURE. UNCLEAR SHETHER AND WHERE SUFFICIENT SLACK
WOULD DEVELOP TO ACCOMMODATE PUBLIC SPENDING PROGRAM
WITOUT FURTHER OVERHEATING. BALANCE OF PAYMENTS
MAY DETERIORATE SLIGHTLY IN 1974, BUT AUSTRALIANS
WOULD WELCOME SOME DECLINE IN RESERVE POSITION. US
DEL TOOK ACTIVE PART IN DISCUSSION AND CHAIRED AFTER-
NOON SESSION IN CAPACITY AS DEPUTY CHAIRMAN OF
EDRC. END SUMMARY

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2. OUTLOOK FOR DEMAND AND OUTPUT: AUSTRALIANS EXPECT NO PROBLEM ACHIEVING "COMFORTABLE" RATE OF GROWTH IN 1974. MAIN CAUSES OF SLOWDOWN IN SECOND HALF 1973 WERE SHORTAGES OF LABOR AND MATERIALS, NOT PLANT CAPACITY BOTTLENECKS OR LACK OF DEMAND. LABOR SITUATION REMAINS TIGHT, BUT MATERIALS SHORTAGES MAY BE RELIEVED SOMEWHAT BY IMPORTS IN 1974. AUSTRALIANS EXPECTED CONTINUED HEALTHY INVESTMENT DEMAND AND WERE SKEPTICAL ABOUT REPORTS OF LAGGING BUSINESS CONFIDENCE, OR TURNING POINTS IN BUSINESS CYCLE (PARA 5, REFDOC). GOA POLICIES WILL AIM TO RELIEVE PRESENT OVERSTRAINED STATE OF ECONOMY AND CREATE SUFFICIENT SLACK TO ENABLE GOVERNMENT PUSH FORWARD MAJOR NEW SPENDING PROGRAMS. SOME SLACK EXPECTED IN PRIVATE HOUSING SECTOR, BUT OTHERWISE UNCLEAR HOW GOVERNMENT COULD PROCEED UNDER PRESENT RESOURCE CONSTRAINTS WITHOUT GIVING SIGNIFICANT IMPETUS TO ALREADY HIGH RATE INFLATION.

3. GERMAN DEL EXPRESSED SURPRISE THAT PHYSICAL BOTTLENECKS WERE NOT CONTRIBUTING TO CAPACITY SHORTAGES IN VIEW VERY LOW OR NEGATIVE GROWTH OF GROSS FIXED INVESTMENT IN 1972 AND 1973. AUSTRALIANS DID NOT ANSWER THIS QUESTION. SECRETARIAT ALSO NOTED DEFLATIONARY EFFECT ON DEMAND IN MANUFACTURING SECTOR OF (A) APPRECIATION OF AUSTRALIAN DOLLAR, (B) TARIFF CUTS, AND (C) TIGHT MONETARY POLICIES. AUSTRALIANS AGREED THIS MIGHT HAVE ADVERSE IMPACT IN INVESTMENT DEMAND, BUT NOTED THAT TARIFF POLICY WAS AIMED AT BRINGING STRUCTURAL CHANGE IN MANUFACTURING SECTOR. HOWEVER, GOA WOULD ASSIST INDUSTRIES IF MAJOR ADVERSE IMPACT ON EMPLOYMENT IS LIKELY TO RESULT. JAPANESE NOTED DRAMATIC TURNAROUND IN FOREIGN PRIVATE INVESTMENT FLOWS AND WONDERED WHAT EFFECTS WOULD BE ON DOMESTIC CAPITAL FORMATION. AUSTRALIANS ADMITTED THERE WOULD BE DECLINE IN INVESTMENT LEVELS, BUT THIS WOULD BE WELCOME UNDER PRESENT OVERSTRAINED CONDITIONS.

4. PRICES AND WAGES: MAIN AREA OF EDRC CONCERN WAS LIMITED OFFICIAL USE

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OUTLOOK FOR RAPIDLY RISING PRICES AND APPARENT LACK OF AUSTRALIAN COMMITMENT TO RESTRAIN INFLATION. UK EXAMINER SET TONE BY WONDERING WHETHER AUSTRALIA HAD ADEQUATE POLICY INSTRUMENTS TO CONTAIN FURTHER PRICE RISES IN VIEW OF GOVERNMENT COMMITMENT TO INCREASE PUBLIC SPENDING AND FOREGO ADDITIONAL TAXATION. IN ADDITION, ELECTORATE HAD REJECTED PRICES AND INCOMES POLICY, AND MONETARY POLICY WAS

SLOW TO TAKE EFFECT. GOVERNMENT WAS SUPPORTING PRINCIPLE OF WAGE INDEXATION AS PART OF 1974 INCOME BARGAINING ROUND, WHICH WOULD GIVE FURTHER IMPETUS TO INFLATION. NOT ONLY WAS GOVERNMENT WITHOUT ANTI-INFLATION INSTRUMENTS, BUT ITS EXPENDITURE AND INCOMES POLICIES WOULD SEEM TO BE DIRECTLY CONTRIBUTING TO ADDITIONAL PRESSURE ON PRICES. SECRETARIAT ADDED THAT PLANNED INDEXATION MEASURES MIGHT BE ADDITIONAL TO EXPECTED 9 TO 10 PERCENT WAGE INCREASE, THUS MAKING SECRETARIAT PROJECTION OF 10 PERCENT CPI RISE LOOK VERY CONSERVATIVE. WHETHER OR NOT THERE WAS INDEXATION, THERE WAS PROSPECT OF STRONG COST PUSH INFLATION, AND REFDOC SHOULD PROBABLY REFLECT THIS MORE STRONGLY. OTHER MEMBERS NOTED AUSTRALIAN EXPECTATIONS THAT LABOR MARKET WOULD REMAIN TIGHT, AND THAT FIRMS WOULD NOT STRONGLY RESIST WAGE DEMANDS. AT SAME TIME, OIL PRICE RISES AND INFLATION IN OTHER COUNTRIES WOULD ADD TO IMPORTED INFLATION.

5. AUSTRALIANS AGREED THAT PRICE PERFORMANCE VERY DISCOURAGING AND ADMITTED THAT COST PUSH PRESSURES WOULD BE PRIMARY SOURCE OF INFLATION IN 1974. IT WAS ALSO TRUE THAT WAGE INDEXATION WOULD PROVIDE FURTHER STIMULUS IF ADOPTED BY WAGE COMMISSION. ALTHOUGH GOA SUPPORTING INDEXATION AS GENERAL PRINCIPLE, IT WAS NOT IN POSITION TO INFLUENCE OUTCOME OF WAGE COMMISSION DELIBERATIONS ONE WAY OR OTHER. AUSTRALIANS AGREED THAT 10 PERCENT CPI RISE MIGHT

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PROVE MODEST; HOWEVER, THEY WERE CAUTIOUS REGARDING SECRETARIAT DESIRE HIGHLIGHT THIS APROBLEM IN REFD0C. THEY ALSO NOTED THAT LONG TERM SUPPLY CONTRACTS FOR DOMESTIC OIL PRODUCTION WOULD PROTECT AUSTRALIA TO LARGE EXTENT FROM OIL PRICE RISES, ALTHOUGH NOT FOR IMPORTED PRODUCTS.

B. POLICY INSTRUMENTS: AUSTRALIAN DEL SAID GOA COMMITTED TO PUBLIC SPENDING PROGRAM AND IS HOPING TO RE-ALLOCATE RESOURCES FROM PRIVATE TO GOVERNMENT SECTOR. HE NOTED GOA'S ELECTION PROMISE NOT TO RAISE TAXES IS LESS THAN FIRM. HE ALSO EXPRESSED PERSONAL VIEW THAT INCOMES POLICY, EVEN IF APPROVED BY ELECTORATE, WOULD HAVE BEEN "WORSE CURE THAN DISEASE." MONETARY POLICY WAS WORKING WELL, HOWEVER, AND GROWTH OF MONEY SUPPLY HAD SLOWED TO 12 PERCENT ANNUAL RATE IN FOURTH QUARTER 1973, WITH FURTHER DECLINE EXPECTED IN FIRST TWO QUARTERS 1974. PRESENT DEGREE OF MONETARY TIGHTNESS ENTIRELY COMPATIBLE WITH POLICY OBJECTIVES, BUT UNLIKELY THAT FURTHER RESTRICTIVENESS WOULD BE DESIRABLE. SOME LOOSENING MIGHT OCCUR IF EXPECTED BUAYANCY OF ECONOMY DID NOT CONTINUE. UK EXAMINER SUGGESTED THAT TIGHTENING LIMITED OFFICIAL USE

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OF LIQUIDITY POSITION LARGELY DUE CHANGES IN EXTERNAL CAPITAL FLOWS, NOT DOMESTIC MONETARY MEASURES, AND IF THERE SHOULD BE FURTHER INFLOWS, THIS WOULD HAVE UNDESIRABLE AFFECT ON MONEY SUPPLY. AUSTRALIANS AGREED THAT FURTHER MONETARY MEASURES MIGHT BE NEEDED IN THIS EVENT.

7. INTEREST RATE POLICY: AUSTRALIAN DEL SAID EFFORTS TO INSULATE MORTGAGE RATES FROM GENERAL RISE IN INTEREST RATES HAVE RESULTED IN DISINTERMEDIATION WHICH HAS REDUCED SUPPLY OF FUNDS AVAILABLE TO BUILDING SOCIETIES AND CAUSED SLOWDOWN IN LENDING. GOA CONSIDERS THIS RESULT TO BE APPROPRIATE IN VIEW EXCESSIVE RESOURCE PRESSURES IN BUILDING SECTOR.

8. PUBLIC FINANCE. WITH REGARD GOVERNMENT SPENDING PROGRAMS, AUSTRALIANS DID NOT SATISFACTORILY EXPLAIN HOW THEY HOPED TO CREATE SUFFICIENT SLACK TO ACCOMMODATE ADDITONAL PUBLIC DEMAND FOR RESOURCES. IN CONVERSATION AFTER MEETING, AUSTRALIAN DEL (STONE) AGREED THAT UNDER PRESENT CIRCUMSTANCES OF LABOR AND MATERIALS SHORTAGE, INCREASED PUBLIC PROGRAMS WOULD RUN RISK OF OFFSETTING ANY SLACK WHICH MIGHT DEVELOP,

AND MIGHT CANCEL OUT NEEDED RELIEF FROM OVERHEATING. BUT, GOVERNMENT HAD ALREADY POSTPONED SOME OF ITS PROGRAMS IN 1973, AND IS COMMITTED TO GOING AHEAD WITH THEM.

9. BALANCE OF PAYMENTS. AUSTRALIANS CONSIDERED SECRETARIAT ESTIMATE OF 15 PERCENT INCREASE IN IMPORTS TO BE ON HIGH SIDE, ALTHOUGH CONTINUED VOLUME INCREASE IS EXPECTED. WITH REGARD EXPORTS, THERE WERE MANY UNCERTAINTIES ABOUT WORLD PRICES AND DEMAND (ESPECIALLY FROM JAPAN), AND SECRETARIAT FIGURES MIGHT BE SOMEWHAT OPTIMISTIC. DEMAND FOR FARM PRODUCTS EXPECTED TO REMAIN STRONG, SLIGHTLY LOWER WOOL PRICES WOULD NOT ADVERSELY AFFECT OUTLOOK. MINERALS EXPORTS WERE IN LARGE PART UNDER LONG TERM CONTRACT TO JAPAN, WHICH WOULD ASSURE SOME STABILITY. CURRENT ACCOUNT MIGHT BE IN SMALL DEFICIT, BUT WIDE VARIATIONS WERE POSSIBLE. AUSTRALIANS NOT VERY CONCERNED SINCE RESERVE LEVELS STILL TOO HIGH AND SOME DECLINE WOULD BE WELCOME. IN LONGER TERM, BOP STRUCTURE LIKELY TO RETURN TO POSITION OF SMALL NET CAPITAL INFLOW WITH MODEST CA DEFICIT, BUT MAGNITUDES WILL BE LESS THAN IN PAST.

10. EXCHANGE RATE POLICY: UK POSED QUESTION ON US DOLLAR LINK LIMITED OFFICIAL USE

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AND AUSTRALIANS RESPONDED THAT THEY WOULD BE PARGMATIC. AUSTRALIAN DEL CONSIDERED THIS SUBJECT TO BE EXTREMELY SENSITIVE AND REQUESTED THAT REFERENCE TO POSSIBLE LOOSENING OF LINK WITH US DOLLAR BE DELETED FROM PARA 55 REFD. COMMITTEE AGREED.

1. EXPORT CONTROLS: IN RESPONSE US QUESTION (REF A, PARA 2), AUSTRALIAN DEL SAID THAT JOINT PARLIAMENTARY COMMITTEE ON PRICES HAD RECOMMENDED CONTROLS ON MEAT EXPORTS, BUT GOA HAD REJECTED THEM AS BEING BEGGAR-THY-NEIGHBOR IN REVERSE.

12. FOREIGN DIRECT INVESTMENTS: IN RESPONSE GERMAN QUESTION, AUSTRALIAN DEL OUTLINED CURRENT LEGISLATIVE SITUATION, LARGELY REPEATING CANBERRA'S REPORTING IN REF D, PARA 6. HE SAID THERE WAS SOME DOUBT THAT AUSTRALIAN INDUSTRIES DEVELOPMENT CORPORATION ACT WOULD BECOME LAW. HE ALSO NOTED THAT LEGISLATION TO CONTROL NON-BANK FINANCIAL INSTITUTIONS AT PRESENT APPLIED ONLY TO DOMESTIC INSTITUTIONS, BUT COULD SUBSEQUENTLY BE EXPANDED TO INCLUDE FOREIGN OWNED INSTITUTIONS. BROWN

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